IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
July 14, 2006 Session

TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA v. WILLIAM WESLEY TERRY

Appeal from the Circuit Court for Davidson County
No. 04C-392 Thomas Brothers, Judge

No. M2005-02035-COA-R3-CV - Filed on January 5, 2007

Travelers Property Casualty Company of America, which paid in excess of $1,200,000 for a fire loss at the insured's condominium complex, filed this subrogation action against the tenant of the owner of one of the condominium units who allegedly caused the fire. Travelers' insured is the owner of the building and common area of the condominium complex. The defendant is a tenant of one of the units within the condominium complex. The lease was silent on the issue of insurance coverage, and it provided that the tenant would be liable for damage caused by his negligence. The trial court summarily dismissed the action against the tenant, finding it was barred by the so-called *Sutton* co-insured anti-subrogation rule adopted by this Court in *Allstate Ins. Co. v. Watson*, No. M2003-01574-COA-R3, 2005 WL 457846 (Tenn. Ct. App. Aug. 22, 2005), *aff'd on other grounds,* 195 S.W.3d 609 (Tenn. 2006). We, however, find *Watson* and the *Sutton* anti-subrogation rule inapplicable to the matters at issue because the defendant tenant is not in privity of contract with Travelers. Accordingly, we vacate the trial court's summary dismissal of this action and remand for further proceedings.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Circuit Court Reversed

FRANK G. CLEMENT, JR., J., delivered the opinion of the court, in which WILLIAM B. CAIN, J., and JON KERRY BLACKWOOD, SR. J., joined.

Donald Capparella, Nashville, Tennessee, for the appellant, Travelers Property Casualty Company of America.

William B. Jakes, III, Nashville, Tennessee, for the appellee, William Wesley Terry.

OPINION

Travelers Property Casualty Company of America filed this subrogation action to recover damages resulting from a fire that occurred on May 6, 2002, which damaged the property of its insured, Elliston Place Quarters Condominiums. The fire and resulting damages of in excess of

$1,200,000 were allegedly caused by an unattended candle in Condominium Unit 303. At the time of the fire, Unit 303 was owned by Johnny and Donna Woods (the "Woods").[1] William Wesley Terry (Terry) rented and occupied Unit 303 pursuant to a Monthly Rental Agreement with the Woods.[2] In the Complaint, Travelers contends Terry is solely responsible for the fire and is liable for the damages at issue.

Travelers provided insurance coverage to Elliston Place Quarters Condominiums (Elliston Place), the owner of a building located at 2325 Elliston Place, Nashville, Tennessee. Pursuant to the policy, Travelers insured the building and common areas of the Elliston Place Quarters Condominiums; however, Travelers did not provide coverage for the contents or furnishings of the individual units.

Elliston Place had no contract with Terry. The only party with whom Terry had a contract was his landlord, the Woods. The Woods-Terry Rental Agreement made no mention of fire or casualty insurance; however, pursuant to the Rental Agreement, Terry was to repair any damage that resulted from his negligence. Elliston Place, Travelers' named insured, was not a party to the Woods-Terry Rental Agreement.

In the Complaint, Travelers alleged that Terry lit a candle in his bedroom of Unit 303, that he left the lighted candle unattended, and that the candle caused the fire that damaged the building and common area of its insured, Elliston Place. Terry denied liability and filed a Motion for Summary Judgment, which the trial court granted based upon a finding that the *Sutton* co-insured anti-subrogation rule adopted by this Court in *Allstate Ins. Co. v. Watson*, No. M2003-01574-COA-R3, 2005 WL 457846, at *1 (Tenn. Ct. App. Aug. 22, 2005), *aff'd on other grounds*, 195 S.W.3d 609 (Tenn. 2006), precludes recovery as a matter of law.

Travelers appeals contending the co-insured anti-subrogation rule is inapplicable because Terry was not in privity of contract with Travelers or its insured, Elliston Place.

STANDARD OF REVIEW

Summary judgments are proper in virtually all civil cases that can be resolved on the basis of legal issues alone, *Byrd v. Hall*, 847 S.W.2d 208, 210 (Tenn. 1993); *Pendleton v. Mills*, 73 S.W.3d 115, 121 (Tenn. Ct. App. 2001); however, they are not appropriate when genuine disputes regarding material facts exist. Tenn. R. Civ. P. 56.04.

Summary judgment should be granted at the trial court level when the undisputed facts, and the inferences reasonably drawn from the undisputed facts, support one conclusion, which is the

[1]The Woods are not a party to this action.

[2]The Woods-Terry Rental Agreement was entered into on June 25, 2001, and remained in effect at the time of the fire.

party seeking the summary judgment is entitled to a judgment as a matter of law. *Pero's Steak & Spaghetti House v. Lee*, 90 S.W.3d 614, 620 (Tenn. 2002); *Webber v. State Farm Mut. Auto. Ins. Co.*, 49 S.W.3d 265, 269 (Tenn. 2001).

The matter before this Court is one of law not fact. The standard of review for this Court on issues of law is de novo, with no presumption of correctness afforded to the conclusions of the court below. *Bowden v. Ward*, 27 S.W.3d 913, 916 (Tenn. 2000).

ANALYSIS

Subrogation permits an insurer "who has been required to satisfy a loss created by a third party's wrongful act to step into the shoes of the [insured] and pursue recovery from the responsible wrongdoer." 73 AM. JUR. 2D *Subrogation* § 1 (2001). The principle of subrogation attempts to place "the burden of bearing a loss where it ought to be," *Sutton v. Jondahl*, 532 P.2d 478, 482 (Okla. Ct. App. 1975), and "allows the insurer to 'stand in the shoes of the insured' and assert the rights of the insured against a third party." *Planter's Gin Co. v. Fed. Compress & Warehouse Co., Inc.*, 78 S.W.3d 885, 891 (Tenn. 2002). Subrogation, however, is not appropriate in every instance, *Id*; *see also* 73 AM. JUR. 2D *Subrogation* § 2 (2001). The so-called *Sutton* co-insured anti-subrogation rule is one of the exceptions. *See Watson*, 2005 WL 457846, at * 2.

The co-insured anti-subrogation rule appears to have its origin in *Sutton v. Jondahl*, 532 P.2d 478 (Okla. Ct. App. 1975). *Watson*, 2005 WL 457846, at *2. In *Sutton*, the landlord's fire insurance carrier sued a tenant and his young son claiming subrogation rights as to a fire loss caused by the son.[3] The jury returned a verdict against the father. On appeal, the Oklahoma Court of Appeals held that the insurance company had no right of subrogation against the father, holding:

> The principle of subrogation was begotten of a union between equity and her beloved-the natural justice of placing the burden of bearing a loss where it ought to be. Being so sired this child of justice is without the form of a rigid rule of law. On the contrary it is a fluid concept depending upon the particular facts and circumstances of a given case for its applicability. To some facts subrogation will adhere-to others it will not. *Home Owners' Loan Corp. v. Parker*, 181 Okl. 234, 73 P.2d 170 (1937).
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> Under the facts and circumstances in this record the subrogation should not be available to the insurance carrier because the law considers the tenant as a co-insured of the landlord absent an express agreement between them to the contrary, comparable to the permissive-user feature on automobile insurance.

Sutton, 532 P.2d at 481-82.

[3]The *Sutton* fire resulted from an experiment conducted by the son, who was using a chemistry set given him by his father.

The *Sutton* co-insured anti-subrogation rule is based in part on public policy grounds and equitable principles. As we explained in *Watson*:

> [T]he *Sutton* rule prevents landlords from engaging in gamesmanship when drafting leases by providing the necessary incentive for them, if they so desire, to place express subrogation provisions in their leases. If such a provision is placed in their lease, tenants will be on notice that they need to purchase liability insurance. If such a provision is not included in their lease, insurers will pass the increased risk along to landlords in the form of higher premiums, and landlords, in turn, will pass along the higher premiums to tenants in the form of increased rent. As the court in *Sutton* did 30 years ago, we acknowledge that this is almost certainly the current commercial reality.

Watson, 2005 WL 457846, at *5. Therefore, there exists a presumption under the *Sutton* rule that the insurance premiums will be paid in part by the tenant's rent payment and the tenant should benefit from the policy as a co-insured. *See Safeco Ins. Co. v. Capri*, 705 P.2d 659, 661 (Nev. 1985). Courts, therefore, consider it "an undue hardship to require a tenant to insure against his own negligence, when he is paying, through his rent, for the fire insurance which covers the premises." *Id*. (citations omitted).

Although the co-insured anti-subrogation rule had not been addressed by the courts of Tennessee until this Court analyzed it in *Watson*, the issue had been addressed by the United States District Court for the Middle District of Tennessee in *Tate v. Trialco Scrap, Inc.*, 745 F.Supp. 458 (M.D. Tenn. 1989).[4] Based upon the reasoning in *Tate* and the majority rule adopted in other jurisdictions as exemplified by *Sutton v. Jondahl*, 532 P.2d 478, *GNS Partnership v. Fullmer*, 873 P.2d 1157 (Utah Ct. App. 1994),[5] and *Tri-Par Investments, LLC v. Sousa*, 680 N.W.2d 190 (Neb. 2004),[6] we concluded in *Watson* that absent an express agreement to the contrary, a tenant and

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[4] "The modern trend throughout the nation is to prohibit lessor's insurers from recovering against negligent lessees unless the rental contract clearly expresses a contrary intent. In fact, this court is aware of only two decisions in this decade in which a court held a tenant liable in a subrogation action brought by the landlord's insurer. *United States Fidelity & Insurance Co. v. Let's Frame It, Inc.* 759 P.2d 819 (Colo.App.1988); *Federal Insurance Co. v. Paulk*, 173 Ga.App. 266, 325 S.E.2d 886 (1985)." *Tate*, 745 F.Supp. at 467. "Because Tennessee law is unclear, and because there is a split of authority among other jurisdictions, this court ultimately bases its prediction of Tennessee law on what it perceives to be the most sound public policy." *Id.* at 473.

[5] The Court of Appeals of Utah in *GNS Partnership v. Fullmer*, 873 P.2d 1157 (Utah Ct. App. 1994), addressed a subrogation claim asserted by a landlord's fire and casualty insurer against a tenant for a fire loss allegedly caused by the negligence of the tenant. The trial court granted summary judgment to the tenant, and on appeal, the Court of Appeals expanded its previous ruling in *Fashion Place Investment, Ltd. v. Salt Lake County*, 776 P.2d 941 (Utah Ct. App. 1989), and affirmed the trial court.

[6] "Because we believe *Sutton* and its progeny are in line with our prior cases and represent the better rule, we explicitly adopt that rule for Nebraska." *Tri-Par Inv.*, 680 N.W.2d at 198.

landlord "are implied co-insureds under the landlord's fire insurance policy, and the landlord's liability insurer is precluded from bringing a subrogation action against the negligent tenant."[7] *Watson*, 2005 WL 457846, at *5.

We must therefore determine whether Terry is a co-insured under the Travelers policy. If so, the co-insured anti-subrogation rule precludes recovery; if not, the summary dismissal must be vacated and the case remanded for further proceedings.

Travelers contends Terry is not a co-insured with its named insured Elliston Place because Terry is not in privity of contract with Elliston Place.[8] Under the *Sutton* rule, "the parties are co-insureds because of the reasonable expectations they derive from their privity under the lease." *Watson*, 2005 WL 457846, at *4 (citing 6A John A. Appleman & Jean Appleman, *Insurance Law and Practice* § 4055, at 77-78 (Supp.1991)).

Here, Travelers provided insurance for Elliston Place, the owner of the entire building and common area; however, Terry does not have a contractual relationship with Travelers' named insured. Terry's only relationship is with Mr. and Mrs. Woods. Thus, Terry is not in privity of contract with Elliston Place or Travelers. Moreover, there is direct evidence in the record to establish that Terry's rent payments did not go toward the fire insurance premiums.[9] In addition to the foregoing, the Woods-Terry Rental Agreement did not induce Terry to believe he would benefit from the Travelers policy or any policy as a co-insured. To the contrary, the Woods-Terry Rental Agreement specifically provided that Terry "shall be responsible for damages caused by his/her negligence and that of his/her family or invitees and guests." For these reasons, we are unable to conclude that Terry was a co-insured or had a justifiable reason to believe he was a co-insured under the Travelers policy.

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[7] Following our ruling in *Watson*, the Supreme Court of Tennessee granted Allstate's Tenn. R. App. P. 11 petition in that matter. *See Allstate v. Watson*, 195 S.W.3d 609 (Tenn. 2006). The Supreme Court affirmed our decision to dismiss the case; however, the Supreme Court based its decision on an ambiguity in the lease agreement, and did not address the issue of whether the tenant was an implied co-insured. The trial court made a finding that the tenant did not intentionally or negligently cause the fire that damaged the apartment; nevertheless, the trial court found the tenant liable because the lease agreement expressly stated that the tenant was liable "for all damages . . . intentional or non intentional." The Supreme Court found "non intentional" was ambiguous and that the parties intended to impose liability upon the tenant only for the fire damage he intentionally or negligently caused.

[8] Terry and the Woods, the lessor, are in privity of contract and privity of estate with one another, *see Griswold v. Income Properties II*, No. 01A01-9310-CH-00469, 1995 WL 256756, at *4 (Tenn. Ct. App. May 4, 1995) (citing 1 Milton R. Friedman, *Friedman on Leases* § 7.501a (3d ed. 1990)), however, Elliston Place is not the lessor, nor does it receive any payment for the insurance premium from Terry's rent. Thus, there is no relationship that places Terry and Elliston Place in privity with one another.

[9] The Woods, Terry's landlords, provided an affidavit that confirms that Terry's rent did not contribute to paying the premiums on the fire insurance policy provided by Travelers.

IN CONCLUSION

The order summarily dismissing Travelers' Complaint is vacated and this case is remanded to the trial court for further proceedings in accordance with this opinion. Costs of appeal are assessed against William Wesley Terry.

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FRANK G. CLEMENT, JR., JUDGE